

**TESTIMONY BEFORE THE HOUSE COMMITTEE ON THE JUDICIARY**

**INDUSTRY COMPETITION AND CONSOLIDATION:**

**THE TELECOM MARKETPLACE**

**NINE YEARS AFTER THE TELECOMMUNICATIONS ACT**

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April 20, 2005

Good afternoon. My name is Carl Grivner and I am CEO of XO Communications, one of the nation's largest facilities-based providers of telecommunications and broadband services. Prior to joining XO as CEO in 2003, I served as Chief Operating Officer for Global Crossing and held various positions at telecommunications companies including Worldport, Cable & Wireless, and Ameritech. I am appearing here on behalf of XO and our competitive industry's trade association, Comptel/ALTS.

I want to thank the Chairman and Ranking Member for inviting me to testify before the Committee on the competitive ramifications of the SBC acquisition of AT&T and the Verizon acquisition of MCI. These mergers are truly monumental. They join the largest incumbent telecommunications providers, SBC and Verizon, with their largest competitors, AT&T and MCI. As a result, competition is certain to diminish in markets throughout the country. I am confident that once the government reviewers examine the evidence in depth, they will find these mergers cause substantial competitive injury to customers, competitors, and vendors. As such, they do not meet the legal standards for approval.

You are to be commended for understanding the important implications of these mergers. I urge you to follow-up on this hearing by pressing the merging parties to completely produce and disclose all information and by ensuring the Department of Justice and Federal Communications Commission undertake in-depth analysis of all possible competitive harms.

Let me begin by telling you about XO Communications, the largest independent competitive local exchange carrier. I believe who we are and what we bring to customers is particularly relevant to issues before the Committee today.

## **BACKGROUND ON XO COMMUNICATIONS**

Originally formed as Nextlink in 1996, XO has expanded its telecommunications offerings from its original 4 small markets to 70 metro area markets in 26 states. Our company provides a comprehensive array of voice and data telecommunications services to small, medium, and large business customers. Our voice services include local and long distance services, both bundled and standalone, other voice-related services such as conferencing, domestic and international toll free services and voicemail, and transactions processing services for prepaid calling cards. XO data services include Internet access, private data networking, including dedicated transmission capacity on our networks, virtual private network services, Ethernet services, and web hosting services.

XO has invested heavily in building its own facilities spending over \$8 billion and constructing over 1.1 million miles of fiber. We have metro fiber rings to connect customers to our network, and we own one of the highest capacity and scalable IP backbones in the industry, capable of delivering data end-to-end throughout the United States at speeds up to 10 Gigabits per second.

Even with this extensive network, we are nowhere close to having ubiquitous on-net coverage – and after AT&T and MCI, we can be considered the nation’s largest local competitive carrier. To build such a network would require over \$100 billion and many decades to construct – not to mention monopoly rights like the Bells have had. Instead, we reach most customers by procuring facilities or circuits from other providers. The major suppliers are the Bells, from whom we lease loop and transport unbundled network elements (pursuant to the Telecommunications Act of 1996) and special access circuits. Where we can find competitive alternatives, we will use them, since their prices tend to be lower, and they actually want to do business with us.

## **INTRODUCTION TO THE MERGERS**

For 40 years, it has been the innovation of entrepreneurial companies coupled with market opening regulations that have brought choice to customers and new technologies and services to the market. This tradition is continuing with the numerous competitive companies that are creating new ways to serve customers using cutting edge technologies. However, the choice customers have seen and the dramatic growth in innovation that has occurred in our industry, started by the break up of Ma Bell, is now threatened by SBC's acquisition of AT&T and Verizon's current deal to purchase MCI.

Whenever companies of this scale merge, there are always the same warnings, and rightfully so. Here are some comments,

“This merger should not be approved as it presently stands because it will limit rather than promote local exchange competition. The proposed merger constitutes a setback for consumers. Furthermore, we saw that when SBC took over Pac Bell, prices rose and service dropped in California.”

“It's hard to see how new competition promised by the Telecommunications Act can be attained if existing monopolies simply combine into larger ones. The concern is especially great when these two companies otherwise would have had powerful incentives to compete against each other.”

By the way, these comments were made by AT&T at the times of SBC's acquisition of Ameritech and the Bell Atlantic – NYNEX merger.

With such increased concentration of power coming to both the business and residential consumer telecom markets what will be the impacts on competition and innovation?

I will begin by putting the mergers in context of the development and status of telecommunications competition, particularly in local markets.

## **THE DEVELOPMENT AND STATUS OF TELECOMMUNICATIONS COMPETITION**

No discussion about the telecommunications industry can take place without recognizing the unique nature of the business. The Bell Operating Companies and other incumbent local companies are not like other American businesses. By virtue of having the sole local telephone franchise for so many years, they have developed an enormous degree of market power. As a result, they have the incentive and ability to harm customers, competitors and vendors.

The government has sought to rein in this market power by regulating the provision of their services and often by restructuring them or limiting their operations. The most well known effort at restructuring by the government was the 1984 divestiture of AT&T of its local telephone operations (the birth of the “Baby Bells”). It created SBC and Verizon, which in the past decade have swallowed 3 of the 7 original Bell companies – and, in the case of SBC, now seeks to acquire its former parent, putting the old Bell system back together again.

In 1996, Congress believed it could eliminate this market power and bring to customers the same benefits in pricing and innovation for local service that were being seen in the long distance market. The Telecommunications Act of 1996 was a watershed law, and it set in motion a massive undertaking: bringing competition to a market dominated by monopolists where tremendous amounts of capital needed to be expended up front and where returns on investment would not be appreciable until economies of scale were reached.

To expedite this process and enhance the chances of success, Congress adopted two fundamental policy mechanisms. First, it permitted the FCC to lift the 1984 Consent Decree provision prohibiting the Bells from entering the long distance business, but only if the Commission found the Bells provided competitors access to their networks at non-discriminatory and pro-competitive terms. This was the so-called “carrot.” Second, it adopted a “stick” -- the Bells were immediately required to offer competitors access to unbundled network elements at cost-based rates.

It is clear from the Congressional debate on the 1996 Act that AT&T and MCI, the two largest long distances providers, were seen as the leading companies to enter the local markets. And, they did. Right after the Act was passed, AT&T bought Teleport for over \$10B, and MCI bought MFS and Brooks Fiber for over \$5B – the three leading facilities-based local telecommunications competitors. Since then, AT&T and MCI have expended many billions of dollars to expand and enhance these local networks. They have acquired about 10 million local residential customers and many millions of business customers.

As a result of this surge in local entry, the FCC permitted SBC and Verizon to enter the long distance business in every market, and it most recently significantly deregulated the requirement that these companies provide unbundled network elements at cost-based rates.

Yet, even though AT&T and MCI have gained a toehold in local markets, facilities-based competition is just beginning, and there is a real question whether it can be sustained. Since I know this business first hand, I know how difficult it is. To truly sustain competition, these firms needed to gain scale. AT&T and MCI were the closest to that goal. They had developed sufficient market presence to negotiate with the Bells on a more equal basis, and the beneficial prices, terms and conditions in their agreements became benchmarks for the entire competitive sector.

Now we are faced with the two largest competitors being snapped up by SBC and Verizon, and the resulting competitive harms to customers and the overall market landscape are easy to detect are substantial.

## **THE EFFECTS OF THE MERGERS ON TELECOMMUNICATIONS COMPETITION**

### **Ten Myths about Competition and the Mergers**

When the mergers were announced, the leaders of the merging parties carried on endlessly about synergies, efficiencies, innovation, globalization, and other corporate buzzwords. Their PR departments worked overtime to paint these mergers as good for all Americans and all

businesses. I'm not surprised. They've got a big job convincing people that greater market concentration is good for them. I've gone through many of their arguments and selected my top ten list of myths used by SBC and Verizon to support these deals.

First, they claim these are ordinary, garden-variety mergers. Nothing could be farther from the truth. As I said at the outset, they will fundamentally reshape the industry. We have seen such events before and so have a sense of their importance in the marketplace. In the 1980s, it was the divestiture of AT&T. In the '90s, the 1996 Telecommunications Act. In this decade, it is these two mergers, and the reason is obvious. These mergers marry the two largest local telecommunications providers with their two largest competitors.

SBC and Verizon are the two dominant local telephone companies, controlling their own local markets (for instance, with a residential market share exceeding 80%) and providing service to 3 out of 4 customers nationwide. In these markets, their bottleneck control has only begun to be eroded by a decade of competition. Yet, in the very short time they have been permitted to enter the long distance business, SBC and Verizon have begun the second and third largest providers. Their residential market shares are about 50% and 40% respectively. These two behemoths also have a firm grip on the wireless market, again controlling almost two-thirds of the customers in the country. And now, they seek approval to merge with the two most prominent local, long distance, and Internet competitors.

Second, don't be fooled by all the rhetoric that the telecommunications industry is somehow so completely different than ten years ago when Congress passed the 1996 law. The basic rules about marketplace competition still apply, and this is precisely where antitrust enforcement and the public interest inquiry need to be focused. Companies like SBC and Verizon, which control bottleneck facilities, have both the incentive and ability to use their market power to harm customers, competitors, and vendors. What's more, they have an insatiable appetite to use that power to leverage themselves into markets that are competitive where they will use their monopoly rents to harm competition.

Third, it has been ten years since Congress opened local telecommunications markets, and competition is just beginning to take hold. Many companies have entered, but they face well-entrenched monopolists – companies that have 100% of the customers and their entire, capital intensive network in place. It will take time to achieve true facilities-based competition. XO embraced the intent of the market opening provisions of the 1996 Act and invested \$8 billion in its own infrastructure. As one of the major new entrants seeking to compete on a facility-by-facility basis, we want to see the law's objective achieved. But, local competitors still have a small share in most markets, and this share will diminish substantially if these mega-mergers are consummated.

Fourth, should the mergers receive approval, don't expect SBC and Verizon to compete head-on. It goes against their basic constitution. Over the past decade, both companies have had numerous opportunities to compete in each other's markets, and they just don't do it. In several major markets – such as Los Angeles, Dallas/Plano, and New York/Connecticut -- their territories abut, and yet neither crosses over. In the SBC-Ameritech merger, the FCC placed conditions on SBC to compete outside its region, and it made only the most minimal effort. I've tried to obtain SBC service here in Washington and had no luck. The reason is easy to understand. SBC and Verizon each know that it has a significant cost advantage in its home market. Consequently, they have, in effect, a tacit non-aggression pact. With these mergers, the value of this pact increases immeasurably.

Fifth, the joke in the old Bell System was that every customer had a choice: a black rotary phone or a black rotary phone. Plastic shells with different colors were a major innovative breakthrough that took decades to come to market. No one seriously believes that companies with market power innovate. They don't have the incentive because these innovations could spin out of control and inject new competitive forces. It was only when the government enabled competitive entry that innovation blossomed. DSL, VoIP, managed services for businesses all were first brought to market by competitors. Consequently, because the mergers greatly reduce marketplace competition, there is absolutely no way innovation will burgeon. Rather, it will be stifled. At a time when our global leadership is being challenged, this would be a disaster.

Sixth, once these mergers are approved, there is no government backstop. By virtue of deregulatory actions by the FCC combined with activist court review, the government has largely ceded its oversight role of SBC and Verizon. In addition, with the Trinko decision by the U.S. Supreme, antitrust actions are hardly useful to address anticompetitive acts in the telecommunications industry. In other words, no one should count on the current government oversight scheme to correct any competitive abuses post-merger.

Seventh, by any objective measure, AT&T and MCI are not failing firms. In fact, both were just named to the “Fortune 100.” You can’t get much more successful than that. AT&T had revenues of over \$30B in 2004; MCI over \$20B. In the 4<sup>th</sup> quarter of last year, AT&T’s EBITDA was \$7B, and MCI’s was \$2B. In the second half 2004, both companies experienced growth in their EBITDA. A recent Wall Street analyst report forecasts that both companies will have positive earnings for the next two years. So, there is absolutely no support for justifying these mergers based on the business weaknesses of AT&T or MCI.

Eighth, the merging parties tout the synergies and efficiencies of the deals, particularly because SBC and Verizon can place their long distance traffic on AT&T’s and MCI’s networks, respectively. But, they already have that capability. Because the long distance market is extremely competitive, efficient “integration” can occur via contract. In other words, all SBC and Verizon need to do is enter into an arm’s length agreement with AT&T and MCI respectively to obtain the very same benefits they claim to be obtaining with the mergers. They also have the possibility of forming other relationships short of merging – all in the name of greater efficiency.

Ninth, SBC and AT&T claim that AT&T’s decision to exit the local residential market is irreversible, but this flies in the face of AT&T’s actions of the past 20 years. In that short time, AT&T has reversed course so often it makes my head spin. First, they’re out of mobile wireless, then in, then out, and then in. As for fixed wireless, they have had so many starts and stops that it gives you whiplash. And, then there’s the entry and exit into the cable business combined with more recent discussions with cable operators about possible partnerships. As a CEO in a



dynamic industry, much of this is understandable. Technologies and markets change. Any decision can be reversed given the proper circumstances.

Tenth, contrary to the public filings of the acquiring companies, these mergers will not improve the national security of this country or otherwise improve the telecommunications services received by the federal government. AT&T and MCI are already prominent government contractors, as are SBC and Verizon, and they are providing the government with innovative, high-quality services. If they remain standalone entities, they would continue to provide these services. In fact, it is the mergers -- by reducing competition and combining networks -- that will generate significant problems for the government. First, it is likely government will end up paying more for telecommunications services. In addition, just when the government wants to have a diversity of facilities to increase the odds of survivability of the network, these mergers combine the largest local networks. These are problems that must be addressed by the government reviewers of the mergers.

**The Merger Review Process: It is Essential that the Department of Justice and FCC Conduct a Rigorous Examination with Complete Information**

Because of the magnitude of these mergers -- their impact on the entire telecommunications marketplace -- and their evident competitive problems, the Department of Justice and the Federal Communications Commission (along with the relevant states) have an obligation to carry out a thorough, deliberate review. In a very real sense, these mergers pose a test to these government officials and to the value and integrity of these merger review processes. I very much want them to pass this test.

I believe it is critical that these mergers be reviewed through the "regular order." That is, the Department of Justice needs to gather complete information to identify markets, pre- and post-merger concentrations, barriers to entry and exit, and other relevant features of market, and then through application of the Merger Guidelines it should determine whether these mergers substantially diminish competition in those markets. And, the FCC needs to do the same in application of its public interest requirements. As I've said, razzle-dazzle and hype about

futuristic competitive alternatives or distant possibilities for market convergence have no place in such an analysis. Determinations need to be based on facts engrained in current market realities, and I believe once this is done the conclusion will be clear: these mergers are bad for customers of all types and sizes and in all locations.

In undertaking this analysis, it needs to be made clear that neither of the filings at the FCC by SBC and Verizon provide much relevant data on the mergers. One could characterize them as long on rhetoric and short on evidence. They were filed quickly after the mergers were announced so that they could get the clock running as soon as possible. Because of this, I call upon the Committee to urge the Department of Justice and FCC to ask for complete information upon which all of us can review the mergers – and the clock should be stopped until that occurs.

### **Local Markets, Increased Concentration, and Competitive Harms**

XO believes that on their face these mergers pose serious competitive concerns and is confident that upon closer scrutiny will fail to meet legal standards. We are now beginning the detailed analysis required to determine precisely the competitive harms. This is going to take months given the many markets involved in these mergers, the difficulty in gathering data (particularly data controlled by the merging parties), and then the complex analysis that will need to be conducted. That said; let me provide some preliminary thoughts about the basic issues involved here.

First, market definitions should be based on well-engrained concepts and current realities.

Applying traditional antitrust analysis – and following the precedent in all recent telecommunications mergers – the relevant product and geographic markets for analyzing the effects on competition of the proposed transactions include: the local high-capacity service market, the local mass market, the long distance termination market, and Internet access and backbone markets. For my company – and for business customers – the most important market is the first – the market for high-capacity local services.

I know that the proponents of the merger allege that the underpinnings of the telecommunications business have changed so dramatically that these market definitions should be scrapped. They allege that geography doesn't matter and that all products are fungible. That may be the case some day far down the road. But, that isn't true today, and it is within the current market context that we need to evaluate these mergers.

Second, the local high-capacity market will see increased market concentration.

By virtue of their century-old monopoly, SBC and Verizon serve the vast majority of customers in these markets – both retail and wholesale. Their market share for the provision local exchange services to business customers in almost all local markets is somewhere between 80%-95% depending on the market. They also provide the dominant share of wholesale circuits to competing providers. AT&T and MCI are the two largest competitors in virtually every local market – dwarfing the rest of the CLEC industry. In two markets -- Cleveland and Milwaukee – where XO has conducted a preliminary inquiry (based on a methodology similar to that used by SBC last year in a submission in the FCC's Triennial Review Process), it has found that the presence of competitors will diminish substantially when AT&T is acquired. And, none of the competitors that remain – of which XO is the largest – have the resources to replace them any time soon. As a result, when these combinations are completed, the SBC and Verizon will increase their local market concentrations significantly.

Third, local market entry cannot occur expeditiously.

Such significantly increased concentrations are troubling, but they could be offset if other competitors could rapidly enter to replace the local facilities and competitive presence of AT&T and MCI. However, this simply won't occur. It's important to understand that AT&T and MCI developed their local presence because of the tens of millions of long distance customers they had and their enormous financial strength. Once AT&T's and MCI's local facilities are bought, they will be integrated into the Bell's facilities and won't continue to be available on the current standalone basis. (As I said earlier, SBC and Verizon have been reluctant to pursue opportunities out-of-region, and they have the incentive to continue this practice even after they acquire AT&T's and MCI's facilities that are out of their home territories.) Thus, both retail customers and carriers who resell their capacity are left without real alternatives.

Fourth, after AT&T and MCI exit, customers will see significant price increases.

Once AT&T and MCI exit the market, SBC and Verizon have an increased opportunity to raise prices to its customers. This harms competitors directly, and because it increases the prices of their inputs, it places the competitors at an extreme disadvantage against the Bell company in acquiring retail customers. This is the very definition of substantial harm to competition.

## **CONCLUSION**

Ten years ago, Congress committed the government to the development of local telecommunications competition. Entrepreneurs took that commitment seriously, and many tens of billions of dollars were expended to build a competitive local market presence. Not surprisingly, in the gold rush atmosphere that ensued after passage of the 1996 Act, more firms entered than could succeed. A shakeout occurred, and a group of more financially and operationally sound competitors have survived. This competition benefits all customers.

Now, however, competition is threatened by these mergers, and it is time for the government to stand tall. I urge you to take this opportunity to renew your commitment to the development of local competition. These mergers require very careful and deliberate investigation – and, as we will prove, would produce serious competitive harms that must be addressed.



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Carl J. Grivner is Chief Executive Officer of XO Communications.

Mr. Grivner's career in telecom and technology spans more than 25 years. He previously served as Chief Operating Officer at Global Crossing. Prior to joining Global Crossing in June 2000, Mr. Grivner served as Chief Executive Officer of Worldport Communications and before that he served as Chief Executive Officer, Western Hemisphere, of Cable & Wireless PLC. Additionally, Mr. Grivner has held various senior executive positions at Advanced Fiber Communications and Ameritech. Mr. Grivner began his career working in sales at IBM. He also served in the United States Marine Corps from 1975-1978. He earned his Bachelor of Science in Biology from Lycoming College.

